OpenFed

POLICY STATEMENT | January 23, 2002

PREDICTED FED DECISION **HOLD**

1.75%

OPENFED OPTIMAL RATE **−25 bps**

1.50%

KEY TAKEAWAY

The Committee expects the real Federal Reserve to hold at 1.75%, yet its own framework judges a modest 25 basis point cut optimal — a small, one-directional gap the Committee attributes to policy sitting slightly tight relative to soft data.

STATEMENT

Information reviewed at this meeting described an economy that is weak but appears to be bottoming. Core PCE inflation stood at 1.16%, well below the 2.0% objective, and the Beige Book documented widespread declining prices for goods and services, shrinking wage and benefit packages, and contract renegotiations invoking 'economic duress' clauses — a broadly disinflationary picture, not one of cost-push risk. Labor conditions remained soft: unemployment at 5.8% stood above the 5.07% estimate of its natural rate, initial jobless claims at 405,000 were still elevated, and the Chicago Fed activity index at -0.05 signaled below-trend growth. Against this, participants gave real weight to forward-looking signs of stabilization. Many Districts expected recovery by mid-year, some sectors were rebounding, the financial stress index at 0.168 was low, and the yield curve at 1.98 was steeply positive, with no inversion. The 3-month T-bill spread near zero, at -0.07, indicated that markets anticipated steady rates rather than a further cut.

On the question of what the real Federal Reserve is likely to do, participants converged from distinct starting points on holding the funds rate at 1.75%. Those most attentive to inflation judged that, with prices falling and no wage-push pressure, there was no case for a hike, while easing further into an anticipated rebound risked stoking inflation once demand recovered. Participants focused on employment acknowledged genuine slack but drew a distinction between a weak labor market that is stabilizing and one that is actively deteriorating; with policy already accommodative after prior easing, they favored preserving limited policy space rather than spending it just as recovery signs emerged, retaining readiness to cut should claims resume climbing. Participants weighing financial conditions saw the elevated Baa spread of 2.87 as reflecting genuine borrowing-cost stress, but not accompanied by any systemic dislocation that would warrant action; a cut, in their view, risked signaling an alarm markets did not feel. Participants tracking market pricing read the near-flat T-bill spread and steep curve as evidence that markets had already priced the trough. The Committee's predictive conclusion was therefore a hold, with no change to the 1.75% rate.

The Committee's own deterministic framework reached a different, though closely adjacent, conclusion: the optimal policy this meeting was a 25 basis point cut. The reference rules pointed in genuinely conflicting directions. The Taylor rule prescribed +75 basis points, but participants discounted it: that output leaned on an r* of 3.708 and on the unemployment gap in a way that, given falling prices and below-trend activity, would have risked deepening disinflation. The other three rules all called for easing — the balanced-approach and ELB-adjusted rules each at -50 basis points, and the first-difference rule at -75, the last of these responding directly to the unemployment momentum of 0.25 that captured still-rising joblessness, with inflation momentum essentially flat at 0.005. With the reference rules judged reliable this meeting, the easing signal could not be dismissed as noise. The framework's -25 recommendation thus split the three easing rules against the outlier Taylor prescription, and participants across perspectives found the magnitude apt: large enough to acknowledge slack and provide insurance against latent credit softness, small enough not to fight a priced-in recovery or signal alarm. The modest -7 basis point T-bill inversion, several observed, roughly matched a quarter-move of expected easing and effectively capped the sensible magnitude.

The gap between the predictive hold and the optimal -25 basis points is small and one-directional. Participants read it as indicating that the current 1.75% stance is slightly tight relative to conditions — near optimal, but with a residual case for one further, measured trim. Because inflation risk was absent and inflation momentum near zero, the asymmetric cost of easing was judged low, so a quarter-point cut was defensible even to those whose instinct was caution. The Committee's optimal conclusion is a 25 basis point reduction; its prediction remains that the real Federal Reserve will hold.

COMMITTEE VOTE

The predictive vote was unanimous, 5-0, to expect no change to the 1.75% funds rate. On the framework's -25 basis point recommendation, the optimal-side deliberation was likewise unanimous, with all five members endorsing the recommendation as-is.